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SUBJECT: ISRAEL'S NEW FINANCE MINISTER COMMITTED TO FISCAL
RESTRAINT

Classified By: Ambassador Richard H. Jones for reasons 1.5 b and d.

Summary

11. (C) Finance Minister Hirschson told the Ambassador that the new government would continue to practice fiscal restraint, and will resist strong pressures from members of the coalition to open the spending floodgates. He pledged that the 2006 budget would not be renegotiated and would keep to the one percent limit on year-to-year expenditure increases, while adjusting spending to address the needs of those most hurt economically by earlier cuts. He also said that streamlining regulation and bureaucracy would be a major GOI goal. On the shekel check clearing issue, Rani Loebenstein, Senior Advisor to the MoF DG, said that the GOI was working with the Israeli banks to come up with a creative solution that would allow the banks to continue their relationships with Palestinian banks. Hirschson lauded recent good news for the Israeli economy, and was especially pleased about the Buffet purchase of an Israeli company, noting that such "non-Zionist" investment for the purpose of making money sent a good signal to investors around the world about the excellent investment opportunities available in the country. He also discussed the importance of tourism to the Israeli economy, saying that he considered it a "strategic" industry which brings in cash and creates jobs. The Ambassador also raised the possible use of customs revenues for humanitarian purposes and the Joint Economic Development Group (JEDG) anticipated for the fall. Hirschson expressed great interest in attending the JEDG. End Summary.

Continued Fiscal Restraint

12. (C) Newly-installed Finance Minister Avraham Hirschson, his Financial Advisors Benny Ayal and Kobi Shalom, and Senior Advisor to the DG Rani Loebenstein met with the Ambassador, DCM, Economic Counselor, and Deputy Economic Counselor on May 16 at his office in Jerusalem. Hirschson was pleased to point out the excellent news that greeted his first week in office -- the report of 6.6% growth in the economy during the first quarter of 2006, the Warren Buffet USD 4 billion cash purchase of eighty percent of the Israeli firm Iscar, the purchase by Deutsche Bank of a portion of Israel Discount Bank (IDB), and the positive reviews of the Israeli economy by investment houses and ratings services. On a cautious note, however, he pointed out that the 6.6% growth number was only for the first quarter and that he was part of a government whose members "all want to spend money." After a comment from the Ambassador, Loebenstein brought up Israel's commitment to the U.S. to maintain fiscal restraint (as part of the 2003 Loan Guarantee Agreement - LGA). Hirschson emphatically stated that the GOI would continue to be very careful and act with the same restraint it has displayed in the last three years.

13. (C) Hirschson noted that as Chairman of the Knesset Finance Committee while Benjamin Netanyahu was Minister of Finance, all of Netanyahu's economic reform proposals had to pass through him and his committee on the way to becoming law. He called himself a full partner in the reforms, and said that he would speak out publicly on the need to continue to act with fiscal restraint (see comment below). The most important thing is investing in people's future, not simply giving them handouts, although help will be earmarked to reach the population groups most in need. The enormous social welfare spending prior to 2003 had no real payoff, and the most important thing to do now is to invest in putting people to work. In response to the Ambassador's question regarding financial promises made to bring parties into the coalition, Hirschson said that those expenditures amount to less than one half percent of the budget. He then stated very firmly that the 2006 budget would not be reopened -- as doing so would send a very negative signal for next year. Spending growth would remain at about one percent this year.

The 2006 budget passed its first reading in the Knesset last week, and there are now about 35 days left to get it passed. He vowed that the government would be strong and keep to the restraints embodied by the budget.

Streamlining Bureaucracy and Regulations

14. (U) Hirschson said that continued reform of the banking system is important, and that it is vital to overcome the problem presented by the over-regulation of the economy in general and the banking system in particular. The 2007 budget will include a noticeable effort to streamline regulations and the bureaucracy.

Shekel Check Clearing for Palestinian Banks

15. (C) Regarding the shekel check clearing issue, Loebenstein assured the Ambassador that the GOI takes the issue very seriously and is working with the Israeli banks involved to find a solution. He could not guarantee that it would be solved, but noted that Hapoalim's July 5 service cutoff date left ample time to come up with creative ideas. Any resolution would require steps by both the banks and the government, and Loebenstein expressed confidence that the issue would be dealt with satisfactorily.

Non-Zionist Investment is Best

16. (C) Regarding Warren Buffet's investment in Israel, Hirschson lauded it as very important, saying that Buffet is not investing for "Zionist" reasons, but rather because he thinks he can make money. In addition, the Deutsche Bank decision to participate in the sale of IDB, which it had been hired to broker, and the positive reviews of the economy by investment houses and ratings services have all sent strong signals to other investors that Israel has good investment opportunities. The Ambassador mentioned that it might be worthwhile to emulate other countries such as Brazil by establishing a country specific "Israel Fund" for trading on a U.S. stock exchange, to make it easier for those desiring to invest in Israel. Hirschson appreciated the idea and noted that the USD seven billion York Fund is interested in investing in the country, as is the Markstone Fund.

17. (U) While saying that Israel has a strong lo-tech sector, Hirschson stressed that Israel excels in hi-tech, and needs to take advantage of this strength. As an example, he cited Israel's water industry. Israel suffers from severe water problems and has developed innovative ways to deal with the problem. Hirschson said that with sufficient investment, Israel could ultimately export up to fifty or sixty billion shekels a year ((USD 11-14 billion) worth of hi-tech solutions for the growing world-wide water industry. The Ambassador remarked that Israel's water expertise could serve as a bridge in its relations with its neighbors, and Hirschson added that water desalinization is also a key to successful development in the Negev.

Eilat-Aqaba Airport

18. (C) Hirschson talked about the importance of tourism to any Negev development plan, and how, as Tourism Minister, he went to Las Vegas to discuss bringing casinos to Eilat and developing a Las Vegas-style "Strip" to attract up to one million European tourists a year. When the Ambassador mentioned a possible joint-Israel-Jordan airport in Eilat/Aqaba, Hirschson said that it was a good idea, but that the Jordanians withdrew their interest in the plan "at the last moment." (Note: According to officials from OPIC - the Overseas Private Investment Corporation - the Jordanians are very interested, but the Israelis are hesitating because of security concerns. End Note). Hirschson said it seemed the idea was still a bit premature but that Israel remains interested in pursuing it. The Ambassador offered to ask Embassy Amman look into clarifying Jordanian views on the issue.

Tourism a Strategic Industry

19. (U) Hirschson said that he sees tourism as a "strategic industry" for Israel -- one that brings in cash, provides employment, and spurs development. He added that Israel is on track this year to have three million visitors, and that the country is becoming a regular destination for cheap shopping and beach vacations for Europeans. He also mentioned the potential of the Evangelical Christian theme park development on the Sea of Galilee to which Israel

contributed 500 dunams (about 125 acres), and which will generate USD 50 - 70 million in investment.

Customs Revenue, JEDG

10. (C) On the issue of funds transfers to the Palestinians, the Ambassador noted that while it is important to isolate the Hamas government, it is also vital to make sure to prevent a humanitarian crisis in the territories. As such, the Gaza border crossings should be kept open as much as possible, and Israel should consider the possibility of using some of the PA customs revenues it is holding to alleviate humanitarian problems in the territories. Hirschson responded that the Prime Minister is mindful of these issues and that they will work on them together. The Ambassador also raised the JEDG meeting to be held in Jerusalem later this year, and Hirschson expressed great interest in participating.

Comment

11. (C) After the meeting, Hirschson issued a public statement, as he had told the Ambassador he would. The statement emphasized that the GOI is committed to the one percent expenditure increase for 2006, and that there is no contradiction between a responsible fiscal policy and the implementation of steps to reduce social gaps. It also noted that deviating from the budget framework to which the government is committed, among others to foreign entities (Note: this refers to the U.S. - Israel LGA), could be a risk to continued economic growth. End comment.

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JONES